

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Institutional Cost Contribution  
Requirement for Competitive Products

Docket No. RM2017-1

**COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE**  
(January 23, 2017)

Pursuant to Order No. 3624, the Association for Postal Commerce (“PostCom”) submits these comments on the Advance Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products. While the Commission should be cognizant of the changing marketplace for competitive products and the potential impact of volume shifts to competitive products when evaluating the appropriate cost contribution for competitive products, PostCom cautions the Commission against taking radical action that could serve to unfairly hamstring the Postal Service’s pricing flexibility and endanger its ability to compete in the competitive marketplace.

**I. The appropriate share is an important component of the Commission’s regulatory framework**

The Postal Accountability and Enhancement Act (PAEA) tasks the Postal Regulatory Commission (PRC) with ensuring that the Postal Service’s (USPS) competitive products contribute an “appropriate” share of the USPS’ institutional costs. Because the USPS derives a substantial share of its operating revenue from market dominant products, the PAEA recognized the need to ensure that USPS does not subsidize its competitive business to create an unfair advantage relative to its competitors.

In addition to explicit requirements that products cover their direct costs, the appropriate share requirement instituted by the PRC acts as a safeguard that protects users of market dominant products from subsidizing use of the USPS' infrastructure if competitive products were to underperform.

As an association representing a broad cross-section of the postal industry, PostCom considers the determination of the appropriate share to be one of the most important functions of the Commission and critical to ensuring the continued health of the postal system for users of both market dominant and competitive products and for consumers as well. For the reasons set out below PostCom believes the PRC should follow a moderate approach; one that recognizes the ongoing need for the PRC to regulate effectively while ensuring that the stable structure that has allowed the USPS to prosper is not unduly disrupted.

After the enactment of PAEA, the PRC originally determined that the appropriate share was 5.5 percent; equal to the estimated share that competitive products were contributing at the time PAEA was enacted. When the PRC first formally reconsidered the appropriate share (RM2012-3) they elected to maintain the 5.5 percent.

The PAEA created a comprehensive governance and regulatory framework reflecting the unique position of the USPS; operating in a very competitive shipping market while simultaneously maintaining monopolies on carrying certain market dominant products and access to the mailbox. While the instant proceeding is focused solely on the appropriate share, the broader context in which the USPS operates should also be considered.

## **II. The Postal Service has changed significantly since the passage of PAEA**

The USPS competitive products look very different today than when PAEA was passed. In fact, since the last time the PRC took up the issue in 2012 USPS has seen impressive growth in volumes, revenues, and contribution:

USPS Competitive Products			
	Total Volume (M)	Total Revenue (\$M)	Total Contribution (\$M)
<b>FY 2011</b>	1,489	8,997	2,317
<b>FY 2016</b>	4,499	18,495	5,999
<b>% Change</b>	202%	106%	159%

When considering the appropriate share that competitive products should contribute to institutional cost, the PRC must consider the change in the USPS performance over the last five years. The USPS ability to grow its shipping and other competitive products indicates that the presence of a minimum aggregate contribution requirement has not impeded its ability to compete effectively thus far. On the other hand, the USPS' competitive products now contribute 16.4% to the USPS total institutional costs<sup>1</sup> which suggests there is a very low probability that adverse performance of the USPS competitive products would impose financial harm on users of market dominant products in the short run.

### **III. Regulations should reflect current market conditions**

In RM2012-3 the PRC considered suggestions that the prescribed contribution be maintained at 5.5 percent. Other parties recommended that it be increased or that it be eliminated altogether. In determining to maintain the 5.5 percent level the Commission cited substantial evidence—including market share estimates and FTC analysis—that USPS was not engaging in the kinds of predatory pricing that this provision of PAEA was designed to safeguard against. In fact, USPS has demonstrated through regular price increases on its competitive products that it is intent on growing net contribution from these services.

In electing to not eliminate the provision, the PRC noted that:

If the Postal Service's competitive products were provided by a stand-alone enterprise, it too would incur fixed operating costs. The appropriate share requirement could be said to represent the fixed costs of the competitive enterprise and should reflect the ways in

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<sup>1</sup> 2016 CRA

which institutional resources are spent on the competitive enterprise. If the Postal Service's competitive products were not required to contribute an appropriate share towards the institutional costs of the enterprise, this could result in the market dominant products cross-subsidizing the fixed costs of the stand-alone competitive enterprise. For this reason, the appropriate share requirement is an important safeguard to ensure fair competition on the part of the Postal Service.

Order No. 1449 at 13. As this observation is still relevant,<sup>2</sup> dispensing with an appropriate share requirement does not appear to be a viable option for the PRC to consider, especially as it appears to have in no way hindered the USPS ability to compete and grow its competitive products.

While in that proceeding the PRC concluded that the 5.5 percent requirement was not too low despite an increasing level of actual contribution since the advent of PAEA, the Commission appropriately cited the relatively small share of USPS volume that the competitive products produce but noted that:

[I]f competitive volumes substantially increase relative to market dominant volume, under the right circumstances, the Commission could consider changing the appropriate share contribution level.

Order No. 1449 at 23. As noted above, competitive products have risen considerably in the last five years, though a substantial amount of observed volume increases have arisen from moving products such as Parcel Select Lightweight (previously classified as Standard Mail Parcels) and commercial First-Class parcels from the market dominant to the competitive category.

Simultaneously, market dominant products have seen continued volume declines, though not to the extent seen during the great recession:

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<sup>2</sup> It should be noted, however, that the Commission's use of the phrase "cross-subsidizing" is not strictly accurate. So long as competitive products cover their attributable costs, there is arguably no cross-subsidization from an economic perspective.

USPS Volume Trend (millions)			
	Market Dominant Products	Competitive Products	Competitive Share
2007	209,925	2,310	1.09%
2008	201,546	1,591	0.78%
2009	176,118	1,401	0.79%
2010	169,501	1,438	0.84%
2011	166,833	1,489	0.88%
2012	157,322	2,533	1.58%
2013	155,195	3,108	1.96%
2014	151,927	3,448	2.22%
2015	150,198	3,959	2.57%
2016	149,824	4,499	2.92%

Despite continued erosion of market dominant volumes and impressive growth on the competitive side, competitive products account for a very small proportion of total USPS volume. So, the Commission must construct an appropriate cost share that takes into account volume shifts while recognizing that competitive products still account for a small fraction of total USPS volume.

The Commission should also considers what has happened to competitive product revenue and contribution over the last ten years:

10 Year Competitive Product Growth				
Year	Revenue (\$M)	% Change	Contribution (\$M)	% Change
2007	9,857	-	1,796	-
2008	8,435	-14.4%	1,832	2.0%
2009	8,133	-3.6%	1,958	6.9%
2010	8,678	6.7%	2,422	23.7%
2011	8,997	3.7%	2,317	-4.3%
2012	11,425	27.0%	3,042	31.3%
2013	13,741	20.3%	3,860	26.9%
2014	15,280	11.2%	4,310	11.7%
2015	16,425	7.5%	4,511	4.7%
2016	18,495	12.6%	5,999	33.0%
Cumulative Growth		87.6%		234.0%

The aggregate growth in volume and contribution since the passage of PAEA is an indicator that the overall structure of the PRC's regulations is working to the benefit of both market dominant and competitive products. In the absence of observed growth in contribution from competitive products, market dominant products—volumes of which continue to decline—would undoubtedly face a larger institutional cost burden.

#### **IV. A moderate approach is needed to support the continued health of the postal system**

The USPS has been very successful in growing its competitive products and has managed its prices responsibly and in compliance with established regulations. But as a safeguard against the possibility of cross subsidization or predatory pricing, the requirement that competitive products contribute a share of institutional costs continues to have relevance.

For regulations to function effectively, they should reflect – to the extent possible without causing undue harm – the existing conditions of the regulated market. The shipping market and the USPS competitive products have changed significantly since the passage of PAEA. A reevaluation is in order.

While use of proportionality based on current contribution or revenue may appear intuitively appealing, PostCom cautions against using such an approach. A sudden large change in this requirement could prove disruptive. For instance, if the USPS were to see a sudden decline in shipping volumes due to some exogenous factor, it may feel compelled to increase prices beyond the point where it can compete effectively. Such an outcome would be harmful, not only to users of the USPS' competitive products, but it would indirectly harm users of market dominant products as well.

Other parties to this proceeding will argue that the PRC should increase the required contribution to institutional costs that competitive products must make, and there is some empirical evidence to support such a position; just as other parties can marshal historical data to

argue on behalf of abandoning the requirement completely. Instead, the PRC should follow a more moderate approach; one that recognizes the ongoing need for the PRC to effectively regulate while ensuring that the stable structure that has allowed the USPS to prosper is not unduly disrupted.

Respectfully submitted,

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